BRIEF IN SUPPORT OF PETITION.

Specification of Error.

The Circuit Court of Appeals erred in holding that petitioner is a moneyed, business or commercial corporation amenable to involuntary adjudication as a bankrupt.

SUMMARY OF ARGUMENT.

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III. The decision of the Circuit Court of Appeals, so far as it holds that no question of public policy is presented by liquidation of co-operatives under the Bankruptcy Act, is probably in conflict with the reasonable implications of the decision in *Liberty Warehouse Co.* v. *Burley Tobacco Growers' Co-operative Marketing Ass'n*, 276 U. S. 71 (1928) 17

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I.

An Important Question of Federal Law Is Presented Which Should Be Settled.

A. *Agricultural Co-operative Associations Are Special Instruments of Public Policy.*

The Wisconsin Legislature has expressly enunciated the policy of the state with respect to agricultural co-operatives.

> "The history of the farm marketing problem in the state and nation, as well as throughout the world, points to a solution chiefly through co-operative marketing efforts of producers. It is, hence, declared to be the policy of this state, in advancing the general good and public welfare, to assist in the organization and development of co-operative associations for production and marketing purposes along lines of dairy and other farm products.
>
> Sec. 94.15, Wis. Stats. (1939).

The Wisconsin Supreme Court in construing the co-op-

erative enabling acts has explained the reasons underlying this policy.

> "The reasons for promoting such legislation are generaly understood. It sprang from a general, if not well-nigh universal, belief that the present system of marketing is expensive and wasteful and results in an unconscionable spread between what is paid the producer and that charged the consumer. It was for the purpose of encouraging efforts to bring about more direct marketing methods, thus benefiting both producer and consumer and thereby promoting the general interest and the public welfare, that the legislation was enacted."
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> *Northern Wisconsin Co-op. Tobacco Pool* v. *Bekkedal*, 182 Wis. 571, 590, 197 N. W. 936, 943 (1924).

Petitioner's articles of organization declare its purposes, among others, to be:

> "5. To secure legislation in the interest of dairy and other farmers.
>
> "6. To encourage collective bargaining and co-operative effort among farmers to the end that the business of agriculture be placed on a sound economic basis." (R. 43.)

Congress has adopted this policy as its own by recognizing the national importance of agricultural co-operatives organized under the state enabling acts. The Agricultural Marketing Act of 1929 is but one example of this recognition.

> "SECTION 1. (a) That it is hereby declared to be the policy of Congress to promote the effective merchandising of agricultural commodities in interstate and foreign commerce, so that the industry of agriculture will be placed on a basis of economic equality with other industries, and to that end to protect, control, and stabilize the currents of interstate and foreign commerce in the marketing of agricultural commodities and their food products. * * *
>
> (3) by encouraging the organization of producers into effective associations or corporations

> under their own control for greater unity of effort in marketing and by promoting the establishment and financing of a farm marketing system of producer-owned and producer-controlled co-operative associations and other agencies. * * *"
>
> 12 U. S. C. A., Sec. 1141.

This court has recognized the public interest involved in such a policy.

> "The opinion generally accepted—and upon reasonable grounds, we think—is that the co-operative marketing statutes promote the common interest. The provisions for protecting the fundamental contracts against interference by outsiders are essential to the plan. This court has recognized as permissible some discrimination intended to encourage agriculture. (Citing) And in many cases it has affirmed the general power of the states so to legislate as to meet a definitely threatened evil. (Citing)
>
> *Liberty Warehouse Co.* v. *Burley Tobacco Growers' Co-operative Marketing Ass'n*, 276 U. S. 71, 96 (1928).

The Wisconsin Legislature has vested considerable regulatory and supervisory powers over agricultural co-operatives in the state Department of Agriculture.

> Sec. 93.06 (5) (6), Wis. Stats. (1939).

From these references the broad purpose and essential character of agricultural co-operatives as instruments of public policy can be clearly ascertained. Each individual association may have a more particular purpose and a lesser scope. But each embodies nevertheless the general concept. The Circuit Court of Appeals failed to perceive the general public purposes woven into the particular association here involved.

B. *Economic Structure of Agricultural Co-operatives Especially Designed to Effectuate Purpose.*

The economic function of the agricultural co-operative is to promote collective, more direct marketing through an organization mutual in character and under decentralized democratic control. Although corporate forms are used and corporate terminology is inartificially applied to them, a basic economic difference between agricultural co-operatives and ordinary commercial corporations exists.

> "For the fundamental difference between capitalistic enterprise and the co-operative-between economic absolutism and industrial democracy is one which has been commonly accepted by legislatures and the courts as justifying discrimination in both regulation and taxation."
>
> *Louis K. Liggett Co.* v. *Lee*, 288 U. S. 517, 579 (1933) (Diss. Op., Mr. Justice Brandeis).

The contrasting characteristics of the two forms will not be pointed out in detail. Several distinctively and exclusively co-operative features should be noted. They are: (1) elimination of profit, (2) democratic decentralization of control and responsibility established by the limitation of one vote to each member regardless of the proportion of his economic contribution and the prohibition on voting by proxy, and (3) the element of mutuality and organizational cohesion introduced by the customary membership contract.

The Circuit Court of Appeals failed to discern the fundamental distinction between agricultural co-operatives and ordinary business or commercial corporations.

C. *Involuntary Bankruptcy Is a Special Menace to Agricultural Co-operatives.*

Ordinary involuntary bankruptcy necessarily has a destructive effect on any business or commercial corporation.

As pointed out in the petition, Congress, for this reason, has not considered unrestricted corporate susceptibility to involuntary bankruptcy desirable. This in itself urges upon the Court consideration of the question presented here since agricultural co-operatives are special instruments of national public policy.

But there is added reason for consideration in the fact that involuntary bankruptcy particularly affects agricultural co-operatives. The operation of the ordinary business or commercial corporation is determined as a matter of economic control. Involuntary bankruptcy offers nothing violently inconsistent with the operating principles of such an organization. In the case of an agricultural co-operative, however, the process of involuntary adjudication negates the fundamental democratic principles of mutuality and cohesion. Under the Bankruptcy Act, if co-operatives are amendable to involuntary adjudication, as few as three members might join in filing an involuntary petition in order to escape from their contract obligations. It is a strange co-operative in which three dissident members can not be found or incited to take such action.

The large monopolistic private interests which have developed so great a hold already upon the dairy industry will have an unsurpassed instrument for destruction of collective marketing obstacles if it is finally decided that organizations like petitioner are amendable to involuntary adjudication.

D. *By Establishing a General Exemption Congress Has Reserved the Question Presented Here for Judicial Determination.*

By making moneyed, business or commercial corporations amenable with certain exceptions, Congress exempted from involuntary adjudication all nonmoneyed, nonbusiness or noncommercial corporations.

The Circuit Court of Appeals seems to limit this exemption to religious, charitable, educational or social organizations. (R. 148.) Yet business or commercial corporations are generally thought of as private organizations for profit. The question whether nonprofit agricultural co-operatives created in the effectuation of a national public policy do not also fall within this exemption should certainly be settled finally. There are ample grounds for arguing or determining that they are not business or commercial corporations within the meaning of the Act.

The existence of this exemption perhaps explains the failure of Congress to exempt agricultural co-operatives expressly. It would be undesirable to except all co-operative associations since the mere designation of an organization as a co-operative insures neither its nonprofit character nor its subservience to the declared public policy. Groups of corporations sometimes, for example, form so-called co-operative associations. Hence the application of the general exemption in cases involving co-operatives has been left to the courts.

E. *This Court Has Reviewed Similar Questions Under the Act.*

Upon certiorari this Court has determined the content of the term "farmer" as used in Section 75 of the Bankruptcy Act.

First National Bank & Trust Co. v. *Beach*, 301 U. S. 435 (1937).

It is submitted that the question presented here is no less important.

F. *Decisions of Circuit Courts of Appeals Inadequately Treat Question.*

Including the two decisions rendered in this matter, six decisions have now been handed down in which the question involved here has been treated. In the four cases previous to this the results were evenly divided:

For Amenability.

Schuster v. *Ohio Farmers Co-op. Milk Ass'n.*, 61 F. (2d) 337, 338 (C. C. A. 6th, 1932).

Re South Shore Co-op. Ass'n., 4 Fed. Supp. 772, 773 (D. C. N. Y., 1933).

For Exemption.

Re Dairy Marketing Ass'n. of Ft. Wayne, Inc., 8 F. (2d) 626, (D. C. Ind., 1925).

Re Weeks Poultry Community, Inc., 51 F. (2d) 122 (D. C. Calif., 1931).

Of these only in the *Schuster* case was the decision rendered by a Circuit Court of Appeals. It is submitted that in that case, as well as this, the Circuit Court of Appeals failed to perceive the public interest in and the true economic character of agricultural co-operatives. For this reason the decisions rendered do not adequately dispose of the question presented in the Pool matter.

II.

The Decision of the Circuit Court of Appeals Is Probably in Conflict With Applicable Local Laws and Decisions.

In its decision the Circuit Court of Appeals said:

> "The state recognizes that a co-operative will engage in business and endeavor to realize profits. * * * Such corporations differ from others not in corporate

function but only in that the profits, instead of being distributed to stockholders, are allotted to patrons ratably in proportion to the amount of business transacted with the latter." (R. 146.)

The adaptation of corporate forms and terminology to co-operative uses is confusing unless the distinctive economic features and purposes of the latter are constantly kept in mind. Fundamentally, the agricultural co-operative is merely substituted for the farmer in his marketing capacity. The proceeds are his throughout.

Lambert v. *Bank of Patch Grove*, 179 Wis. 359, 191 N. W. 555 (1923).

The co-operative neither earns nor distributes a profit. Its income is calculated to meet operating expenses. If the calculated amount is not expended, the balance belongs and is returned to the contributors, but not, of course, as a profit.

185.01. DEFINITIONS. In this chapter, unless the context or subject matter otherwise requires:

"Corporation" means a corporation not organized under this chapter.

"Association" means a corporation organized under this chapter.

"Co-operative basis," as applied to a corporation means that: (a) Each member has one vote and only one vote, (b) the rate of dividends upon stock is limited to eight per cent, (c) the net proceeds from the business of such corporation are distributed to the patrons in proportion to the volume of business transacted by said patrons with the corporation; provided, that deductions may be made, as required or authorized by the law of this state, or, in the case of a foreign corporation, by the law of the state of such corporation's creation.

"Net proceeds" mean the total proceeds minus expense of operation and cost of goods sold.

Section 185.01, Wis. Stats. (1939).

It may be said of the Supreme Court of Wisconsin, as it was of the Supreme Court of Indiana:

> " 'If the Supreme Court of Indiana were called upon to decide whether or not this Co-operative Dairy Marketing Association of Fort Wayne, incorporated, was a corporation organized for pecuniary profit, any lawyer could absolutely anticipate its decision.' "
>
> *Re Dairy Marketing Ass'n of Ft. Wayne, Inc.*, 8 F. (2d) 626, 628 (D. C. Ind., 1925).

The bankruptcy power of Congress is, of course, paramount. But Congress has left to the states the definition of the types of nonmoneyed, nonbusiness or noncommercial corporations. Similarly Congress excepted particular kinds of moneyed, business or commercial corporations, but left their definitions to the states. And it has been held that such definitions are authoritative provided that in the main the resulting system be uniform.

> *Re Union Guarantee & Mortgage Co.*, 75 F. (2d) 984, 984-985 (C. C. A. 2d, 1935) (Cert. Den. 296 U. S. 594, 1935).

This rule is consistent with that recently established by this Court:

> "Except in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the State. And whether the law of the State shall be declared by its Legislature in a statute or by its highest court in a decision is not a matter of federal concern."
>
> *Erie R. Co.* v. *Tompkins*, 304 U. S. 64, 78 (1938).

It should be determined whether the states have power to define uniform types of nonbusiness or noncommercial

corporations exempt from involuntary adjudication, and whether, if they have, the decision of the Circuit Court of Appeals is in conflict with the applicable law of Wisconsin.

III.

The Decision of the Circuit Court of Appeals Is Probably in Conflict With Applicable Decisions of This Court.

The Circuit Court of Appeals, in its decision, declared:

> "There is nothing in the nature of a co-operative association which conducts business for the purpose of realizing profit for those with whom it does business to remove it from the Congressional definition. While such associations are to be encouraged as instrumentalities looking to aid of their patrons, they are not eleemosynary or charitable organizations. Rather they represent merely a banding together of producers for their common financial advancement. The sole motive is pecuniary gain. (R. 148.)
>
> It is said that it is the public policy both in the state and nation to promote and nurture the development of co-operatives and that to hold them subject to bankruptcy is to interfere with such public policy. The reasoning is fallacious. To hold a corporation amenable to bankruptcy is not in any wise to interfere with its activities as a useful association or to penalize it." (R. 149.)

This reasoning is erroneous.

In the first place, it is recognized that the public interest in corporations which are special instruments of public policy extends beyond their creation and operation to their demise.

> *Re Union Guarantee & Mortgage Co.*, 75 F. (2d) 984 (C. C. A. 2d, 1935) (Cert. Den., 296 U. S. 594, 1935).

It is a grave mistake to assume that such a corporation can be abandoned and dissolved without affecting the gen-

eral purpose of its creation. That a co-operative is such a corporation has been recognized by this Court.

> *Liberty Warehouse Co.* v. *Burley Tobacco Growers' Co-operative Marketing Ass'n*, 276 U. S. 71 (1928).

The Circuit Court of Appeals, adverting to the fact that petitioner had made an assignment for the benefit of creditors by way of liquidation under state law, declares that there is no reason in public policy why liquidation should not be effected in bankruptcy where preferences are not recognized rather than under state law where they are upheld.

By preference the Circuit Court of Appeals perhaps meant the rule that the patrons' products and proceeds of sale thereof are held in a fiduciary capacity by the co-operative and the title thereto does not vest in it.

> *Lambert* v. *Bank of Patch Grove*, 179 Wis. 359, 191 N. W. 555 (1923).

This rule is, of course, a necessary corollary of the basic economic principles under which the co-operative operates. Liquidation is but one phase, although the concluding one, in its operation. The basic principles governing its existence, together with their corollaries, must be observed in that phase as well as in any other. The existence of this so-called preference merely illustrates the necessity of the supervision of the state over these special instruments of its public policy from creation to dissolution.

It is submitted that this Court should consider whether the decision of the Circuit Court of Appeals is not in conflict with the reasonable implications to be drawn from the *Liberty Warehouse Co. Case.*

Conclusion.

The question presented here is as truly national in scope as is the co-operative movement in agriculture. Its importance may be measured by the considerations of public policy embodied in the movement and by the obvious solicitude of Congress itself that involuntary bankruptcy should not defeat such considerations.

The question is one of federal law requiring construction of an Act of Congress. Such construction, it appears, requires a careful determination of the nature and purposes of state-created agricultural co-operatives. The determination of the Circuit Court of Appeals probably conflicts with applicable state law and, further, with the spirit of decisions rendered by this Court.

For these reasons it is submitted that the petition herein should be granted.

Respectfully submitted,

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